APPENDIX

Notes for FOMC Meeting
February 6, 1979
Scott E. Pardee

As Alan Holmes reported during the telephone meeting on January 12, the dollar had come under heavy selling pressure in late December. Our intervention numbers had swelled, by a further $1.2 billion of sales of German marks and $104 million of Swiss francs. By year-end, some $8.2 billion of the facilities available to the U.S. authorities had been used, including $6.6 billion of the $30 billion November 1 package. At the peak in early January the Federal Reserve swap debt amounted to $5.5 billion of German marks, Swiss francs and Japanese yen. In marks, we had committed some $4.6 billion of the $6 billion line and were beginning to become concerned over our availabilities should heavy intervention continue to be necessary. As it turned out it wasn't, and today I can report a picture of considerable progress in repaying swap debt.

This of course is based on the rather impressive recovery of the dollar from the year-end depths. Dollar rates are currently 2-4 percent above year-end lows. At first, the recovery was a surprise to most market participants, who had been so bearish that they forgot just how oversold, in a technical sense, the dollar had become during the last months of 1978. Leads and lags were a major adverse factor. In effect, almost everyone who was going to sell dollars in early 1979 had sold them in late 1978. Thus dollar rates stabilized in the first weeks of January more on the lack of new selling pressure than as a result of buying.

Taking advantage of the dollar's better tone, on January 18 the Bundesbank took steps to absorb some of the excess liquidity in the German banking system through a tightening of reserve requirements and a hike in the Lombard rate. The Swiss and Japanese authorities also relaxed some of the more onerous barriers to inflows of funds which they had imposed last year. The German monetary policy step in particular gave us all a real scare, but the dollar's resiliency in the face of such action began to impress the market.

The next hurdle for the market was the President's State of the Union address and budget presentation, with follow-up testimony by senior officials, including Chairman Miller and Secretary Blumenthal. At first, the market remained skeptical about the message coming out of Washington of austerity in fiscal policy and restraint in monetary policy. But reports that Congress was perhaps in a receptive mood added to the credibility of that message. Moreover, to many market participants here and abroad the fact that the Federal funds rate remained steady even after some weeks of weak monetary aggregates was seen as tangible evidence of the determination of the U.S. authorities to deal with the inflation and dollar problems.

At the same time, the prolonged political upheaval in Iran began to raise serious economic questions, stemming from the halt of the oil exports from that country on one hand, and the potential cancellation of major import contracts by the Iranian government and Iranian firms on the other. Moreover, there was the immediate problem of how Iran was to pay its current bills. The market gradually came to the view, as Governor Partee suggested in the December meeting, that the Iranian situation was potentially more dangerous to Japan and Western Europe than the U.S. Consequently, the Iranian development led to some large shifts of funds into dollars. In part, this was attributed to exporters in Germany and Japan who had already sold dollars forward against their own currencies and now reversed themselves on the possibility that they would not be receiving dollars after all. In part, it was by some portfolio managers, who saw the Iranian situation as being a major uncertainty for those currencies for several months if not longer. The rush was not all into dollars; the gold price and other commodity prices have been strong.

As the balance of exchange market forces began to tip in favor of the dollar in late January the interest rate differential suddenly began to bite, with the three-month Euro-dollar rate more than 6 percent above that for

Euro-marks, more than 8 percent over the rate for Euro-yen, and 10 percent over three-months for Euro-Swiss francs.

The movement into dollars on the last days of January and the first days of February was in very substantial volume and would have led to a sharp rally for the dollar except for the massive intervention of central banks. Last week, we and the German, Swiss, and Japanese central banks sold a total of $1.8 billion into the market. This was partly to avoid the outbreak of disorderly conditions on the upside for the dollar and partly to enable us to repay swap debt. The dollar settled back somewhat yesterday and today. In all, from the early January peak of $5.5 billion, we have repaid a total of $1.5 billion. The Swiss franc debt has been halved, the Japanese yen debt cleared away completely, and the mark debt has been reduced by $1.1 billion to $3.5 billion.

I must stress, however, that what we saw last week was a shift of perception of risk on the part of market participants and not a change in the market's evaluation of fundamentals. Significant improvement in the U.S. trade deficit is still a forecast rather than an actuality. And expectations about the near-term outlook for inflation in the U.S. are as gloomy in the exchange market as before. It's just that the market's attention was diverted to other concerns for a while, and bearish psychology could resurface very quickly.

F.O.M.C. MEETING
FEBRUARY 6, 1979

REPORT OF OPEN
MARKET OPERATIONS

Reporting on open market operations, Mr. Sternlight made the following statement:

During the seven weeks since the December 19 Committee meeting, the Account Management has aimed for conditions of reserve availability consistent with Federal funds trading at or slightly above 10 percent. This represented a slightly firmer stance than was sought just prior to the December meeting. Despite a progressive weakening in estimated growth of the aggregates, the System's funds rate objective was maintained--in response to supplementary instructions from the Committee. Thus in late December, when the aggregates, taken together, were estimated to be slightly to the soft side of the specified ranges, the Desk was directed to hold its objective steady pending a further review at the Committee's telephone conference call on January 12. At that time, growth was estimated to be even a bit weaker but after reviewing broader factors such as the state of the economy, price behavior and the international position of the dollar, the Committee left the objective unchanged. Significant further weakening for M_1 and M_2 in the two months ending in January showed up in the data becoming available late last week, but with today's meeting so close, the Account Management continued its approach unchanged.

As it worked out, the funds rate was in fact at or slightly above 10 percent on most days. The exceptions were several days around year-end when the combination of large dollar flows and cautious bank reserve management produced unusual demands for excess reserves which the Desk could not fully meet, leaving the funds rate higher than desired, and a few Wednesday afternoon occasions of undesired ease or tightness. The average rate over the whole period was about 10.15 percent. Discount window borrowing averaged a little over $1 billion for the period--up several hundred million from the previous intermeeting period.

To achieve reserve objectives, the System Account was a very substantial outright seller of securities over the past seven weeks--to an extent that required two increases in the leeway to change outright System holdings between Committee meetings. Sales were nearly continuous through the period, except for the several days of tightness around year-end, and again yesterday, when the Desk provided temporary reserves through repurchase agreements. Total sales and redemptions came to nearly $5.7 billion. This included sales of about $1.6 billion of bills and $360 million of agency issues in the market, about $2,750 million of bills sold to foreign accounts, and $900 million of bills redeemed at maturity. The first of the large sales of bills in the market caused some temporary uncertainty among the legions of Fed watchers, largely because of the infrequency of such sales, but the second sale of bills and the sale of agencies went off with barely a ripple.

Several factors combined to produce the abundance of reserves, including declines in Treasury balances, high float, seasonal return flows of currency after the year-end, and later in the period reductions in required reserves and warehousing of foreign currency for the Treasury. Reserves are expected to be abundant through the next statement week, but after that we expect to supply reserves for some weeks. Right now it appears that a return to the usual $3 billion of leeway to change outright holdings between Committee meetings--down from the temporary $6 billion level--should provide sufficient operational flexibility. At some time though, the Committee may wish to consider enlarging the normal leeway limitation given the prospect of longer intervals between Committee meetings and the growth in the size of factors affecting reserves.

Despite the steady Federal funds rate, most market interest rates declined during the period since the last meeting, especially in the latter part of the interval. At first, yields on a number of instruments moved higher, partly in reaction to the System's slight firming at the December meeting, as well as to indications of strength in the economy and persistence of inflation. After about mid-January the trend in rates was downward as the market became more impressed with the lack of growth in the aggregates, the improvement in the dollar overseas, and the prospect of more moderate credit demands from the Treasury and other borrowers than had been anticipated earlier.

Most Treasury issues maturing in 1 to 5 years declined about 25 to 50 basis points in yield over the period. Longer Treasury issues were down about 10 to 30 basis points. In the short-term area, there has been an especially marked decline in rates on bank CD's which had been bid up aggressively in the final months of 1978 but came down by 50 to 100 basis points since mid-December. Part of the rise and subsequent decline was probably seasonal, but also banks apparently over-prepared for anticipated credit demand and rate pressures which failed to develop as expected. On the other hand, Treasury bill rates came down a more moderate 25 basis points or so for longer bills and there was little net change in rates on 3-month bills, where supplies were enlarged by System sales and a switch from foreign official account purchases to sales as the dollar improved. Yesterday, 3- and 6-month bills were auctioned at average rates of about 9.19 and 9.31 percent, compared with 9.24 and 9.52 percent the day before the December meeting.

Today the market is bidding on $2.25 billion of 8-year Treasury notes, the first part of the February refunding operation to replace $3 billion maturing notes held by the public and raise about $1 1/4 billion. The second part of the operation will be the sale tomorrow of $2 billion additional 8 3/4 percent bonds of 2008. We expect to roll over the System's $1.7 billion holding of maturing notes, divided between the two issues in about the proportions they are offered to the public.

There is currently a diversity of view in the markets about rate prospects. Few participants are convinced that we have already seen the peaks in the current cycle, but a number seem to feel that rates are close enough to their highs that some moderate moves to get invested are appropriate. Others believe that significant further increases could lie ahead--to be approached when monetary aggregates resume their growth and the monetary authorities continue their anti-inflationary efforts.

James L. Kichline
February 6, 1979

INTRODUCTION -- FOMC CHART SHOW

For this meeting of the Committee the staff has reassessed the forecast of economic and financial developments in 1979 and extended the forecast through 1980. This represents an unusually long period for the judgmental forecast, but we felt it would be helpful to take an early look at all of 1980, particularly in light of the Humphrey-Hawkins Act. The forecast has been prepared in an environment of more than usual uncertainty regarding the interpretation and implication of recent economic and financial developments. Thus a good deal of risk attaches to the forecast we will be presenting today.

The first chart in the materials distributed to you displays the principal policy assumptions that underlie the forecast. Interest rates are assumed to remain near current levels in the first half of 1979 and to move moderately lower thereafter. This assumption is consistent with the midpoints of the longer-run interest rate ranges for 1979 presented as Alternative B in the Bluebook. M-1 growth is assumed to average 6-1/4 per cent over the next two years, after adjusting for the effect of ATS shifts on M-1 growth. In addition, some further downward shift of money demand is assumed as discussed in the Bluebook. For fiscal policy we have assumed outlays of $493 billion in the current fiscal year and $538 billion in FY 1980.

The differences between the staff's Federal budget outlook and that of the Administration are shown in the next chart. Our estimate of outlays in 1979 is similar to that of the Administration but we anticipate larger outlays in 1980 reflecting our somewhat higher interest rates and level of unemployment, as well as an assumption that certain cost limiting measures will not be accepted by the Congress. On the receipts side, the difference in 1980 is accounted for mainly by our exclusion of the costs of a real wage insurance program--which presently does not appear to have much support in the Congress. The resulting budget deficit is shown in the bottom panel. Even though the projected deficit in 1980 is about $4 billion larger than the Administration plan, we would view our fiscal assumptions generally as being restrictive.

The next chart displays selected indicators of recent economic activity. Production, employment, and retail sales all rose strongly in the final quarter of 1978. Over-all, real GNP reportedly rose at a surprisingly strong 6 per cent annual rate. Thus we apparently entered this year with a good deal of momentum. The limited information available for activity in January, notably the employment situation, suggests appreciable strength.

Mr. Zeisel will continue the presentation with a discussion of the staff's domestic nonfinancial forecast.

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Joseph S. Zeisel
February 6, 1979

FOMC CHART SHOW

Although the economy apparently entered this year with a good deal of momentum, fundamental forces still appear to suggest a distinct slowing of activity by spring. The first chart of the nonfinancial section presents the average annual rates of growth of real GNP and its major sectors over the past two years, and our projections for the next two. As is evident, we are forecasting a significantly weaker rate of real growth in each of the key income generating sectors--housing, business fixed investment, and government--and an associated softening of consumer demand. Over the next two years, real GNP is projected to expand at less than a 2 per cent annual rate. While a slowing to such a pace increases the economy's vulnerability to shocks, we are not forecasting a recession, given the policy assumptions, and the apparent absence of substantial distortions in the economy at the present time.

A major factor retarding growth in our forecast is the weakening of housing. Activity in this sector has so far remained surprisingly strong, reflecting in no small measure the support to deposit growth at thrift institutions provided by the money market certificates introduced last June. But, as is illustrated in the top panel of the next chart, growth of savings inflows has slowed in recent months. As indicated in the middle panel, outstanding mortgage commitments may have topped out, and this month's Redbook confirms other reports of tightening mortgage markets. Moreover, it is our judgment that despite the attractiveness of homeownership as a hedge against inflation, the substantially increased costs of taking on larger mortgages at higher interest rates will increasingly put a damper on housing demand this year. As the bottom panel dramatically portrays, the monthly carrying cost for an average new conventional mortgage rose to $500 by the end of 1978--a 50 per cent increase over the past 3 years.

The next chart presents in the top panel our projection of housing starts. We now anticipate that starts will bottom out at about 1,650,000, annual rate at the end of this year and then edge up during 1980 as somewhat easier financial conditions permits a reemergence of the strong underlying demand associated with a high rate of family formation.

The key point made in the bottom panel is that while housing starts remained at a high level for much of 1978, real housing expenditures were no longer contributing to economic growth. And residential construction is expected to be a noticeable drag on real activity through most of this year.

Turning to the business sector, the top two panels of the next chart indicate recent trends in real orders for capital equipment and construction contracts. They suggest substantial upward momentum for capital spending in the short term. However, there are indications that this may be temporary ; both series appear to be either leveling off or turning down. In addition, a slower pace of capital spending over the balance of 1979 is indicated by the latest Commerce Department survey of plant and equipment outlays, illustrated in the bottom panel.

The outlook for capital spending in 1980 is obviously more speculative. As indicated in the next chart, our projections of over-all activity are consistent with a decline in capacity utilization rates in manufacturing from the present 86 per cent to about 83 per cent toward the end of 1980. In this environment there should be less pressure for expansion of capital stock, and given an expected weakening of profits, we are forecasting a virtual leveling out of these outlays in real terms over the course of 1980.

The next chart illustrates the diminished contribution to over-all expansion expected from government spending during the next two years. As the top panel shows, the annual growth of total government purchases--Federal, State and local--in real terms is expected to average little above 1 per cent during 1979 and 1980; this reflects an actual decline of such Federal financing programs as countercyclical revenue sharing and public service employment, and a more moderate rise in outlays for a wide range of other governmental programs. As the bottom panel shows, the Federal Government high employment budget surplus is projected to show only a modest change between 1978 and 1979 since personal and business tax cuts are about offset by mandated payroll tax increases and the impact of inflation in raising income tax receipts. However, with no new tax cut initiatives in 1980--but with the effects of inflation and the scheduled payroll tax increases--the high employment budget moves further into surplus next year.

Our projections of investment and government activity are reflected in a substantial further moderation of disposable income growth, as shown in the top panel of the next chart. This slowing does not bode well for consumer spending prospects. Growth of consumer outlays was also sustained in the recent past by a substantial rise in consumer credit. As indicated in the second panel, the ratio of total household debt to disposable income has reached record levels, increasing the vulnerability of consumer outlays, particularly for durables, to any weakening in the rise of disposable income. Furthermore, with the savings rate already at the lower end of historical experience--the third panel--it seems unlikely that growth of real consumer outlays will outpace income. Consequently, as the bottom panel shows, we have projected a rise in real consumer spending of only about 2 per cent, annual rate, over the next two years--about in line with the rise of real disposable income.

We do expect a further improvement in the trade deficit during the projection period which will help to sustain over-all economic activity. But on balance, as shown in the next chart, we anticipate real GNP growth to moderate during this year, averaging about a 2 per cent annual rate of growth over the four quarters, and then to level off at about a 1-1/2 per cent rate in 1980.

Consistent with the slower pace of over-all activity, we anticipate smaller employment gains over the projection period--as shown in the top panel of the next chart. Although we are also projecting slower labor force growth than in the past few years, reflecting both poorer job prospects and smaller population gains, the unemployment rate--shown in the bottom panel--is projected to move up steadily beginning this spring, reaching a level of about 7 per cent toward the end of 1980.

Despite growing labor market slack, inflation is expected to continue to be a critical problem for the economy. In the next chart are portrayed the core elements of the persistent inflation problem--the continuing rise in wages and the poor productivity performance of the economy. As the top panel shows, we expect that hourly compensation will rise about as rapidly on average in 1979 as in 1978, reflecting the lagged influence of recent cost of living increases, the results of the heavy round of contract negotiations and the hikes in minimum wage and in social security taxes that went into effect on January 1. Some modest easing of compensation increases is expected in 1980, in response to smaller payroll tax increases, the continued slackening of labor market pressures and some impact of the guidelines program.

As the middle panel indicates, we expect little help from improved productivity performance in damping the impact of rising wages on labor costs and prices. The continued abysmal performance of productivity remains baffling. But in any event, only modest productivity growth is to be expected in an environment of such small gains in over-all output. As a result, we are projecting continued rapid increases in unit labor costs, totaling about 8-1/2 per cent during 1979 and 7-1/2 per cent in 1980, paralleling the pattern of wage movements.

The top panel of the next chart illustrates GNP prices excluding food and energy, which are projected to move generally in line with unit labor costs. We remain moderately optimistic in regard to food supplies and prices later this year and in 1980, reflecting prospects for good grain crops and some improvement in pork supplies. Our projections call for a 9-1/4 per cent food price increase this year as opposed to the 12-1/2 per cent rise during 1978. We are projecting an 8 per cent increase in 1980. Energy prices are projected to accelerate in response to the 14-1/2 per cent OPEC price increase during 1979; for 1980 we are assuming a rise in oil import prices of 7-1/2 per cent--about equal to average inflation. Over-all, we are projecting a modest deceleration in GNP price increases, from 8-3/4 per cent during 1978 to 8 per cent this year, and about 7-1/2 per cent in 1980.

Mr. Truman will now review the international situation.

FOMC PRESENTATION
E.M. Truman
February 6, 1979

The upper left-hand panel of the first international chart shows the decline in the weighted-average foreign exchange value of the dollar since the middle of 1976. The decline began to accelerate in the fourth quarter of 1977 and was only partially reversed following the November 1 initiatives. Over the past two months the dollar has been relatively stable. The foreign exchange value of the dollar, in nominal terms, is now about 17 per cent below its level in mid-1976 and about 15 per cent below its level in September 1977.

As is shown in the lower left-hand panel, in the first quarter of last year the average price level in foreign industrial countries began to fall relative to the U.S. price level. This deterioration in the relative price performance of the United States has offset some of the competitive advantage resulting from the decline in the dollar's nominal value. As is shown in the chart, we expect that, over the projection period, the U.S. inflation rate will remain relatively high, but the differential should narrow to about 1½ per cent per year--compared with almost 3 per cent over the past year.

The upper right-hand panel of the chart shows the staff's outlook for real economic activity abroad. Average growth in real GNP in foreign industrial countries picked up somewhat in 1978, and real growth is expected to continue at an average annual rate of about 3½ per cent over the projection period, while growth in the United

States slows. The expected relative rise in the level of economic activity abroad is summarized in the last panel.

The factors I have just reviewed are among the major determinants of the staff's outlook for U.S. international transactions that is presented in the next chart. As depicted in the upper left-hand panel, the value and volume of non-agricultural exports are expected to increase briskly over the next two years, though not as rapidly as in recent quarters. The volume of such exports is expected to increase at an annual rate of around 9 per cent and the value at a rate of about 18 per cent.

At the same time, as shown in the lower left-hand panel, the volume of non-oil imports is expected to expand relatively slowly reflecting the slower growth of the U.S. economy as well as the lagged effects of the dollar's depreciation. Even with substantial price increases, the value of these imports should increase over the next two years at an average rate of less than 9 per cent per year.

The upper right-hand panel illustrates the erratic upward trend of U.S. oil imports. In our forecast we have tried to take account of recently announced, and prospective, OPEC price increases and to make some guesses about the effects of the Iranian production situation--which we have assumed will mainly affect the time pattern of oil imports in 1979. On this basis, we expect that the U.S. oil import bill will rise $5-6 billion per year in both 1979 and 1980. Most of the increase will result from higher prices.

As shown in the final panel, the net effect of the components that I have just reviewed, together with little expected change in our agricultural exports, yields an improvement in the trade balance in 1979 and 1980. The top line in the chart depicts the gradual rise over the projection period in net exports of goods and services as measured in the GNP accounts.

The final international chart summarizes U.S. international transactions over the past three years. The left-hand column shows the current account balance for these years as well as the staff's projection for 1979 and 1980. You will note that we expect the United States will record its first current account surplus in 4 years in 1980. The middle column indicates that in 1977 and 1978 capital inflows in the form of increases in foreign official reserve assets held in the United States were about twice as large as our current account deficits. However, the pattern of these increases has been erratic; the largest inflows have roughly corresponded to periods of sharp downward pressure on the dollar in exchange markets during the last quarter of 1977 and the first and fourth quarters of 1978. The third column shows other transactions, derived essentially as a residual. These are mostly private capital transactions. Such transactions at times are a source of downward pressure on the dollar. However, the size of any actual net outflow is inversely related to the volume of official purchases of dollars.

Given the improved outlook for the U.S. current account that I have presented, the staff expects little further change in the average nominal foreign exchange value of the dollar over the projection period, although with the expected relatively high U.S. inflation rate this implies a small real appreciation of the dollar. I would draw two inferences from this outlook for a stable dollar and a declining U.S. current account deficit. First, foreign monetary authorities will have less inducement to purchase dollars to add to their holdings of reserve assets in the United States. Second, the lower current account deficit in 1979 should be accompanied by a substantially reduced net private capital outflow or, even, by a modest net inflow.

Mr. Kichline will now conclude our presentation.

James L. Kichline
February 6, 1979

CONCLUSION -- FOMC CHART SHOW

Total credit flows consistent with the staff's economic forecast are shown in the first chart of the last section of your packet. Funds raised by nonfinancial sectors in 1979 are projected to recede from the high levels of last year. The bulk of the decline is attributable to reduced demands by the Federal Government, which is expected to finance a portion of the deficit this year by drawing down its cash balances. Total borrowing by other sectors is not expected to grow in 1979 and 1980, reflecting the effects of financial restraints and decelerating growth of economic activity.

As shown in the bottom panel, commercial banks and thrift institutions are expected to supply a somewhat smaller volume of credit in the next two years than in 1978. These institutions will likely be less willing lenders this year in light of reduced liquidity positions and an expected further need to rely upon borrowed funds rather than deposit flows to meet credit demands. Other suppliers of credit, particularly insurance companies and pension funds, are expected to be in a more comfortable position to finance economic activity.

Total borrowing by nonfinancial corporations, shown in the next chart, is projected to rise appreciably in both 1979 and 1980 from the already high levels reached last year. Although the economic forecast projects a slowing of growth in capital expenditures, expansion of internally generated funds is also expected to moderate, thereby maintaining pressures on external financing. The increased volume of funds raised is expected to come from long-term sources, where funds should be available. Short-term markets seem likely to be relatively tighter, partly because of the pressures on banks. In addition, however, the bottom panel shows that heavy short-term borrowing in the past two years has pushed the ratio of short-term to total debt outstanding to fairly high levels. Later this year and in 1980 there probably will be strong pressures to begin funding such debt in long markets to relieve balance sheet distortions.

In contrast to the corporate sector, the next chart shows that household sector borrowing is projected to decline somewhat this year and next from the extraordinary level in 1978. Despite expected further rapid growth of house prices, mortgage borrowing in 1979 and 1980 is expected to remain around the level of the past two years, which reflects the effects of financial restraint. The sharp contraction of mortgage borrowing that has occurred during past periods of monetary restraint is projected to be avoided, as a result of both the partial insulation of the mortgage market from the direct effects of monetary restraint and sustained demands for housing. Consumer instalment and other borrowing is projected to diminish later this year and in 1980, given projected slower growth of durable goods purchases. Relative to income, however, consumer borrowing is projected to remain quite high.

The economic forecast and associated credit flows assume growth of M-1 averaging 6-1/4 per cent in 1979 and 1980. As shown in the next chart, nominal GNP expanded at a fast pace in the last quarter of 1978 while M-1 growth adjusted for the effects of ATS slowed. Thus the income velocity of money rose substantially and a strong velocity increase is also expected this quarter. Later this year and in 1980 the forecast assumes that stronger demands for money relative to GNP will be evident. In order to hold money growth to 6-1/4 per cent the 3-month bill rate is expected to decline only a little this year and next, shown in the bottom panel. The Administration in its forecast assumes 3-month bill rates about 1/2 percentage point lower on average this year than shown on the chart and more than a percentage point lower in 1980.

The economic forecast of the Administration and that of the staff also differ in a number of ways, as shown on the next chart. Growth of nominal GNP expected in 1979 is quite close, but in 1980 the staff forecast is significantly below that of the Administration. The difference is even greater for real GNP in 1980 when the Administration projects growth of 3-1/4 per cent, or more than twice the staff's forecasted rate of growth; business fixed investment, residential construction outlays and consumption expenditures are all growing at appreciably faster rates in 1980 than in our own forecast. The Administration also expects considerable improvement in inflation this year and next with the GNP implicit deflator in 1980 projected to rise about 6-1/2 per cent compared to 7-1/2 per cent in the staff forecast. Presumably the less rapid price increases stem from the assumed greater effectiveness of the wage-price restraint program, since the price deceleration occurs with little additional slack in resource utilization than now exists, as illustrated by maintenance of a 6-1/4 per cent unemployment rate in 1979 and 1980 in their projection.

M-1 growth assumed in the staff's forecast is 6-1/4 per cent adjusted to take account of the effects of ATS. Judging from the econometric exercises we have undertaken, nominal GNP growth as in the Administration forecast could also be financed by roughly similar monetary growth. The model simulations, however, suggest very low probabilities of jointly achieving the lower inflation and lower unemployment forecasts by the Administration.

The final chart in the package displays the results obtained from model simulations employing 1 percentage point slower and faster rates of M-1 growth than in the 6-1/4 per cent base forecast. Each of the forecasts presents a picture of slow or moderate economic growth accompanied by still high rates of inflation even into 1981. There seems to be little in the way of attractive options for monetary policy. Tightening further would bring on the likelihood of a recession later this year or next while an easier policy would probably produce higher rates of inflation over the longer run.